

## Meaning and Significance of Health Check-up Results

Accompanies the *Financial Health Checkup* workbook

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### Net Assets Trends

“Net assets” (also known as “net equity” and “net worth”) is the difference between the organization’s total liabilities and total assets. The trend in net assets is the most reliable indicator of the direction of an organization’s financial health.

An asset is a resource or something useful owned by the organization.

A liability is an organization’s obligation to pay.

### Profitability

Note that the term “nonprofit” has to do with an organization’s tax-exempt status, not its financial performance. For healthcare organizations, nonprofit criteria include such things as a charitable purpose and using assets for the charitable purpose and not paying dividends to shareholders.

The “operating margin” used here as a profitability indicator is the proportion of profit remaining after subtracting operating expenses from operating revenues. Without a healthy margin, the organization would have problems maintaining reliable services, weathering difficult times, training staff, and developing new services. The operating margin here is calculated as follows:

$$(\text{Revenues}-\text{expenses})/\text{expenses}$$

### Solvency indicators

The debt-ratio assesses the extent to which an organization is highly leveraged and how may be burdened by debt or is relatively free of debt. Compared to the current ratio described below, the debt ratio might be considered a long-term measure of solvency. It is calculated by dividing total liabilities by total assets. The lower the ratio the better. Financially healthy nonprofit organizations usually have debt ratios of less than .25.

The current ratio, or quick ratio, assesses how readily current obligations can be met. The current ratio is calculated by dividing current assets by current liabilities. The higher the ratio stronger the organization’s near-term ability to meet its obligations. In behavioral health, a current ratio of less than 2.0 is a cause for concern.

Current assets are assets available for use as cash within a one-year cycle. These typically include cash, pre-paid expenses, and accounts receivable.

Current liabilities are those liabilities due within a one-year cycle.

Working capital is the capital available during the period. It is current assets minus current liabilities.

The days of working capital is the number of days that a program may operate relying on its working capital. It is calculated by dividing organization's working capital by its average daily cost of operation, which is determined by dividing the expenses, minus depreciation, for the year by 365 days. A more frequently used measure is the days of cash, which is calculated by dividing the sum of an organizations cash and cash equivalents by its average daily cost of operation, which is determined by dividing the expenses, minus depreciation, for the year by 365 days.

Depreciation: The amount of value that an asset declines over a period, such as the amount that vehicles, equipment, buildings, and leasehold improvements decline.

It should be remembered that days of cash and the days of working capital are calculated retrospectively, according to the average level of expenditures for the previous year. These would not be sensitive to significantly changed expenditure levels that occurred during the past year or are projected for the next year.

### **Days in receivable**

Accounts receivable are the amounts owed to the organization by insurance plans, patients, and funding bodies. These amounts are recognized as an asset when the service is provided, but converting the receivables to cash as soon as possible is important. The days in receivable is the average number of days from the serviced being rendered to the organization receiving cash for providing the service. This is important because the lower the days in receivable, the faster the organization receives cash, an increase in the days in receivable can be flag billing problems, and the longer the time in receivable, the less likely it is that the receivable will be paid. Before electronic billing, 75 days or more in receivable were not uncommon. Now many providers have days in receivables of less than 60 days. Ninety days or more represents a serious problem.

It makes sense to treat patient accounts receivable separately from grants-receivable because the methods of payment are different and combining them can be misleading. Days in receivable are calculated as follows:

$(\text{Accounts receivable}/\text{revenue generated}) \times \text{number of days in year}$